

Service Date: July 1, 1983

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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IN THE MATTER of the Application)	UTILITY DIVISION
by the MONTANA POWER COMPANY for)	
authority to establish increased)	DOCKET NO. 82.8.54
rates for electric service in the)	
State of Montana.)	ORDER NO. 4938b

ORDER ON MOTIONS FOR RECONSIDERATION

FINDINGS OF FACT

1. On May 12, 1983, the Commission issued Order No. 4938a, which disposed of all matters then pending.

2. On May 26, 1983, the Montana Consumer Counsel (MCC) filed a Motion for Reconsideration concerning the two following issues:

- (1) Inclusion/Exclusion of the Construction Trust for Capital Structure;
- (2) Pro Forma Interest.

3. On May 27, 1983, the Montana Power Company (MPC) filed a Motion for Reconsideration concerning the following issues:

- (1) Return on Common Equity;
- (2) REC Revenues;
- (3) Captive Coal.

MONTANA CONSUMER COUNSEL
(1) INCLUSION/EXCLUSION OF THE CONSTRUCTION TRUST
FOR CAPITAL STRUCTURE

4. MCC argues on reconsideration that the construction trust should be included in the capital structure as debt. Further, MCC states that the PSC made a factual error when it stated: "MPC is not actually paying currently the interest on the debt." In support of its arguments, MCC quotes at length from several sections of the construction trust agreement. The Commission agrees that interest is paid by the trustee and that MPC is the Guarantor of the trust.

5. However, neither of these observations reflects a factual error in Order No. 4938a. The trustee, not MPC, is currently paying the interest. On the financial statements of MPC, construction trust interest is being capitalized (see MPC 1982 Report to Shareholders p. 34).

6. The Commission sees little similarity between the construction trust debt and long-term debt. The Company makes current interest payments on long-term debt, while interest on the construction trust is capitalized. Long-term debt proceeds may be applied to any corporate

purpose; construction trust advances are associated only with C.W.I.P.

7. Based upon the discussion above, the Motion for Reconsideration to include the construction trust in the capital structure by MCC is DENIED.

(2) PRO FORMA INTEREST

8. In the second part of its Motion for Reconsideration, MCC urges the Commission to include the construction trust interest in the proforma interest calculation. This Commission has consistently held that the tax benefits associated with construction period interest should be flowed through to consumers. The calculation of pro forma interest can be expressed as a simple equation: rate base + C.W.I.P x the weighted debt cost. This is the methodology sponsored by MCC and adopted by this Commission in numerous past Dockets. However, in its Motion for Reconsideration, MCC has proposed a new pro forma calculation: rate base + C.W.I.P x the weighted debt cost + interest on the construction trust.

9. The Commission agrees with MCC that the tax benefits associated with construction trust interest should be flowed to consumers. Consistent with the calculation of past pro forma interest, the Commission finds that the formula rate base + C.W.I.P. x the weighted debt cost is proper. When the construction trust is included in the capital structure (for tax calculation purposes only), the weighted debt cost increases from 5.12 percent to 5.59 percent. This change produces pro forma interest in the amount of \$34,579,000. This increase in pro forma interest reduces the overall revenue requirement by \$2,867,000.

10. The Commission finds the inclusion of construction trust in capital structure for tax calculation purposes only to be proper in this proceeding. The resulting approved effect is a revenue requirement reduction in the amount of \$2,867,000.

MONTANA POWER COMPANY

(1) RETURN ON COMMON EQUITY

11. In its motion for reconsideration, MPC disagreed with the Commission's determination of cost of common equity. The Company found fault with the Commission's use of a Company specific yield and an industry-derived growth rate in determining the appropriate return on equity in this Docket.

12. The Commission emphasizes that its goal in determining cost of common equity is arriving at a cost which reasonably represents investor expectations. The approved cost level of ;

14.14 percent in this proceeding represents a reasonable determination of investor expectations for MPC. The method of determining the 14.14 percent cost rate was appropriate for the particular circumstances in this Docket. In Order No. 4918b, Montana Dakota Utilities (MDU) Docket No. 82.6.40, the Commission averaged the DCF results of MCC witness Smith's Tables B-6 and B-7

(14.15 percent) to reflect properly the investor expectations for MDU. Using the "MDU method" (MPC yield + average of three most important growth rates and all growth rates) for MPC yields an equity cost of 13.94 percent, which is somewhat lower than the approved cost of 14.14 percent. MPC equity cost of 13.94 percent results in a growth rate of 3.13 percent $[13.94\% - 10.81\% \text{ (MPC's approved yield)} = 3.13\%]$. This analysis shows that the approved growth rate of 3.33 percent, which the Commission views as a reasonable proxy for or estimate of MPC's expected growth, is liberal when compared to the 3.13 percent growth figure which would result from using the "MDU method." More importantly, 14.14 percent is liberal compared to 13.94 percent for a return on common equity. Applying the "MDU method" to data from Dr. Smith's Table B-4 of Appendix B (industry yield + the average of the three most important growth rates and all growth rates) yields an industry cost of equity of 14.25 percent. Since the Commission believes that MPC is slightly less risky than the industry as a whole, the approved equity cost rate of 14.14 percent is certainly reasonable and comparable vis-a-vis the calculated industry equity cost level of 14.25 percent.

13. In summary, the Commission believes that the approved equity cost rate of 14.14 percent represents a reasonable level of investor expectations for MPC. The Company's Motion for Reconsideration of this particular issue is, therefore, DENIED.

(2) REC REVENUES

14. In its Motion for Reconsideration, MPC disagreed with the Commission's adjustment which increased REC revenues by \$2,284,000. The basis for MPC's argument is their belief that this Commission has no jurisdiction over the reasonableness of rates which are set by the Federal Energy Regulatory Commission (FERC).

15. As an alternative, MPC proposed that the Commission take notice of the March, 1983, Company filing with FERC for an REC rate increase of \$999,873. The Commission could then treat that filing as a known and measurable change to the rate case which would accurately conform to expected FERC REC rates in the future.

16. The Commission finds that, for purposes of this case, FERC tariffed rates should be accepted with known and measurable changes. Therefore, the REC revenue adjustment of \$2,284,000, should be disallowed in this proceeding. The Commission also takes official notice of MPC's March, 1982, FERC filing concerning REC rates. Having taken such notice, the Commission accepts the related revenue request of \$999,873 as a known and measurable change in Docket No. 82.8.54. The Commission, therefore, finds the REC revenue increase adjustment in the amount of \$1,000,000 (rounded from \$999,873) to be proper in this proceeding. The net effect of these two aforementioned adjustments is a decrease of REC revenues in the amount of \$1,284,000 $(\$2,284,000 - 1,000,000 = \$1,284,000)$.

17. The Commission believes that MPC must more actively seek FERC relief for REC revenues rather than hiding behind the cloak of pre-emption. If the costs for jurisdictional customers are rising

and requiring relief, then the costs for REC customers must also be rising and requiring relief. The Commission believes it is totally logical that the Company, therefore, should file simultaneous rate cases with this Commission and FERC. Such simultaneous filings would eliminate inequities between jurisdictional and non-jurisdictional rate relief and put a halt to MPC playing the game of pitting this Commission against FERC. The Commission, therefore, determines that prior to MPC's next filing of rate relief with this Commission (i.e.: Colstrip 3), the Company is directed to file an REC rate relief case with FERC. In future cases, simultaneous filings with this Commission and FERC will be appropriate for equitable rate relief.

(3) CAPTIVE COAL

18. In its Motion for Reconsideration, MPC challenges the Commission's captive coal adjustment on several grounds:

- a. With no evidence that prices charged by Western Energy were unfair, the Commission should have ignored comparable profits evidence.
- b. Montana-Dakota Utilities Company v. Bollinger, ____ Mont. ____ 632 P.2d 1086(1981) (Knife River) does not require a two-part test, but rather, allows the Commission to choose which test it will use.
- c. The record is insufficient to support a finding that Western Energy's profits are excessive.
- d. The Commission's use of natural resource companies was improper because MPC did not know this information would be used for this purpose
- e. The Commission ignored its own Findings of Fact 110, 112, 118, 119, 120, 121, 122 and 126.
- f. The Commission ignored evidence which calculated returns based on fair market value of Western Energy's assets.

These claims will be addressed in turn.

19. The Company's first argument stands for the proposition that if the Commission finds a competitive market and there is no evidence of unfair prices, the Commission should end its inquiry and refuse to adjust the Company's coal expense. (Motion, p.9)

The Commission previously rejected this position (Order No. 4714a, Conclusion of Law No. 5). This is precisely the same position argued by MDU in the case which resulted in the Knife River case, and the same position argued by MPC in MPC v. PSC, Cause No. 65611 (2nd Judicial District, Silver Bow County, February 10, 1982); Mont. , 40 St. Repr. 805 (May 31, 1983). Two district courts have rejected the argument and the Supreme Court has done so twice. MPC's preference for the competitive price method is clear. The Motion offers no new reasons that support the position. The Commission believes that it must examine all evidence presented, balance its weight and then make a decision. It will not "end its inquiry" after examining only one side.

20. MPC has misread the Commission's Order regarding its interpretation of the Knife River case. The Commission did not say that Knife River required use of both tests. The order states clearly that

the Commission believes it must use both tests in order to protect ratepayers. (Finding 130) Knife River does not limit or prohibit such a position.

21. The real substance of MPC's argument seems to be with its claim that the record evidence does not support a finding of excessive profits. This claim rests on the Company's belief that Dr. Wilson's testimony is highly flawed because the coal companies he used are not comparable. The problem of comparability was addressed extensively in the original Order. As with most evidence received in a rate case, the information is not perfect; however, the Commission must weigh what is offered and make a decision. For reasons explained in the order, the record shows that there are fewer problems with Dr. Wilson's comparable company data than with Mr. Gibbons'. The Commission specifically addressed the limits of the comparable coal company data by providing for expenses providing higher profits in view of evidence regarding natural resource companies as a class. This approach provides a "safety net" against overly heavy reliance on the admittedly imperfect information presented on coal companies. The Commission notes that such classifications are widely used in the financial community. There is no reason why the Commission should not consider such information. The sum and substance of Mr. Gibbons' testimony is that MPC's ratepayers should pay coal expenses that reflect a profit enjoyed only by the very top moneymakers in the business. The Commission rejects that position.

22. MPC's arguments regarding use of natural resource company data is puzzling. without legal authority, MPC seems to suggest that the Commission's review of evidence presented is limited to the way in which witnesses choose to use a particular piece of evidence or how witnesses choose to interpret evidence. The Commission's approach is logical and reasonable. It reviewed Dr. Wilson's testimony regarding profits on other sectors of the economy. The Commission logically concluded that natural resource company profits were more relevant than those non-coal companies suggested by Dr. Wilson. If there were factual errors in Dr. Smith's exhibit or if there were other reasons which suggested the Commission should not rely on the exhibit, MPC could have easily requested a rehearing so that such concerns could be placed on the record.

23. The Commission believes that its decision addresses the substance contained in findings MPC claims it ignored. Findings 110, 118, 119, 120, 121 and 122, are all summaries of MPC sponsored testimony regarding the comparable price approach. By its finding that both price and profit must be reasonable, the Commission disposed of the need to analyze the comparable price method in detail. As clarification for the Company, the Commission finds no particular problem with the evidence, as far as it goes.⁽¹⁾ Simply, it does not go to the issue of whether both prices and profits are reasonable.

(1) It should be noted, however, that the Department of Revenue letter discussed in Finding 119 deserves little weight: (1) It is a preliminary determination (2) Western Energy is itself contesting the Department's conclusion (3) the Commission has no information as to the methods or reasons that support the conclusion and if those methods or reasons are valid for ratemaking purposes.

24. Finding 112 footnote 1 was addressed. That footnote 1 states that comparability of companies was not percent. The limitations on available data are discussed at Finding of Fact 133.

25. The Company is correct in its claim that the Commission did not specifically address the issues noted in Findings of Fact No. 126. The criticism also goes to the Company's claim that the Commission ignored evidence regarding profits based on the fair market value figures. By noting that both Mr. Gibbons and Dr. Wilson found such an approach to be circular the Commission believed it had adequately conveyed why it was not seriously considered. For clarification purposes, the Commission finds that the record shows that the approach is circular and, therefore, considers it unreliable. In addition, without information comparing profits of other companies using the same method, the Commission has no basis for concluding that MPC's return is too high, too low or just right.

26. As an alternative to its opposition to the Commission's use of the comparable profits method, the Company claims that if the method is used, it should not be applied to sales of coal for generation for customers not subject to MPSC jurisdiction (Motion; p. 13).

27. There is a serious problem with this reconsideration. The problem lies in a proper matching of all expenses and revenues. Traditionally, both the Company and the Commission have treated the MPC as a unitary system for rate making purposes. That is, costs, revenue, and rate base have never been allocated between jurisdictional and non-jurisdictional sales, and none was proposed in this order, except regarding the captive coal expense. If there were such an allocation for all revenue and expense items, it would be appropriate to make the adjustment suggested by MPC. For example, such an adjustment was made by the Commission for captive coal expenses for the Montana-Dakota Utilities Company because that Company allocates all revenue and expense items among the various states it serves, as well as making a separate allocation for off system sales. Absent such an allocation of all items, an allocation of only one would result in a mismatch.

28. Based upon the discussion above, the Motion for Reconsideration relating to the captive coal adjustment is DENIED.

29. The following chart shows that the adjusted revenue requirement in this proceeding is \$30,348,000, as approved by the Commission.

MONTANA POWER COMPANY
Adjusted Revenue Requirement
1981 Test Year
(000)

	Approved Pro Forma in order No. 4938a \$189 524	Reconsid- eration Pro Forma Interest Adjustment	Reconsid- eration Net REC Revenue Adjustment \$ (1,284)	Reconsid- eration New Approved Pro Forma \$188,240	Increase Required For 11.63% Return \$30,348	New Total \$218,588
Operating Revenues						
Operating Revenue Deductions						
Purchased Power	\$ 29,558			\$ 29,558		\$ 29,558
Fuel	24,157			24,157		24,157
Other O & M Expenses	63,864			63,864		63,864
Total O&M	\$117 579			\$117,579		\$117,579
Depreciation & Amortization	16,232			16,232		16,232
Investment Tax Credit Deferred	0			0		0
Amortization of Investment Tax Credit	(531)			(531)		(531)
Deferred Income Taxes	6,972			6,927		6,927
Taxes Other than Income	16,344		\$ (1)	16,343	\$ 18	16,361
Federal Income Taxes	(4,915)	\$ (1,247)	(550)	(6,712)	13,010	6,298
Montana Corp. License Tax	(581)	(196)	(87)	(864)	2,047	1,183
Total Revenue Deductions	\$151,100	\$(1 443)	\$ (638)	\$149,019	\$15,075	\$164,094
Utility Operating Income	\$ 38,424	\$ 1,443	\$ (646)	\$ 39,221	\$15,273	\$ 54,494
Amortization of Profit on Debt. Reacquired at Discount	0					
Balance For Return	\$ 38,424	\$ 1,443	\$ (646)	\$ 39,221	\$15,273	\$54,494
Rate Base	\$468, 562			\$468,562		\$ 468,562
Rate of Return	8.20%			8 37%		11.63%

RATES & REBATES

30. In Order No. 4938a, the Commission established provisions for a rebate of what was found to be slightly excessive interim rates (See Finding Nos. 203-205). The fact that Order No. 4938b arrives at a final authorized revenue level less than the 4938a level further complicates an already complex rate/rebate situation.

31. For at least two reasons -- (1) an equitable correlation between overcharges and rebates among customers and (2) avoidance of unnecessary complexity -- the Commission finds that the final rate and rebate levels should be treated as set forth below.

32. First, the Company should file rates which generate the final authorized revenue levels as provided in this Order. These rates will reflect the appropriate uniform percent increase resulting from Docket No. 82.8.54 and will be made effective for service rendered on and after June 30, 1983.

33. Second, the Company must calculate the rebate dollar amount. This amount should reflect the total net difference between the effective rates (4938 rates and 4938a rates, the latter including the rebate) and the final authorized revenue levels (4938b) plus interest over the period of time those rates were in effect (October 19, 1982 through June 30, 1983). This total rebate amount is to accrue interest at the Company's overall rate of return -- 11.63% as provided in Finding No. 29.

34. The rebate amount, with accumulated interest, is to be refunded to customers in the bills rendered during the month of December, 1983. Except for the Electric Contract customers, who are treated on an individual basis, the one-time refunded amount should be calculated such that it effectively represents a uniform percent decrease in rates.

CONCLUSIONS OF LAW

1. Applicant, Montana Power Company, is a corporation providing electric and natural gas services within the State of Montana and as such is a "public utility" within the meaning of ' 69-3-101, MCA.

2. The Montana Public Service Commission properly exercises jurisdiction over the Applicant's operations pursuant to Title 69, Chapter 3, MCA.

3. The rate of return allowed meets the constitutional requirement that a public utility's return must be "commensurate with returns on investments in other enterprises having corresponding risks and sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital." Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 591, 603 (1944).

4. Section 69-3-201, MCA declares:

Utilities to provide adequate service at reasonable charges. Every public utility is required to furnish reasonably adequate service and facilities. The charge made by any public utility for any heat, light, power, water, telegraph, or telephone service produced,

transmitted, delivered, or furnished or for any service to be rendered as or in connection with any public utility shall be reasonable and just, and every unjust and unreasonable charge is prohibited and declared unlawful.

It is with this statute in mind that the Commission considers MPC's purchases from its wholly-owned subsidiary, Western Energy. Recognizing that it can go no further than to consider MPC's cost of fuel, the Commission also believes that sole reliance on a transfer price comparison has clear limitations, thus it determines from an examination of Western Energy's profits that MPC is paying excessive prices for coal; therefore, the adjustment set out in this order is necessary to assure that the requirements of 69-3-201, MCA are met.

ORDER

1. The Montana Power Company shall file rate schedules by July 15, 1983, reflecting the increased level of revenues of \$30,348,000 in lieu of the revenues approved in Order No. 4938a. Total annual revenues will be approximately \$218,588,000.
2. The Montana Power Company's final rate calculations are to be supported by working papers showing: (1) test year sales per schedule for each season and rate; (2) Order No. 4938b final rates and (3) the product of (1) and (2) above, summed, equalling the total revenue requirement less the existing revenue requirement.
3. The Montana Power Company is to refile the Docket No. 80.4.2, Order Nos. 4714d and 4714e rate schedules reflecting order No. 4938b approved revenues. Working papers should accompany this filing.

4. Rate schedules filed shall comport with all Commission determinations set forth in this order and in Order 4938a, except as modified by this Order.

5. All motions and objections not ruled upon are denied.

6. DONE AND DATED this 30th day of June, 1983, by a vote of 4-0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

Thomas J. Schneider, Chairman

John B. Driscoll, Commissioner

Howard.L. Ellis Commissioner

Danny Oberg, Commissioner

ATTEST
Madeline L. Cottrill
Commission Secretary
(SEAL)

NOTE: You may be entitled to judicial review in this matter. Judicial review may be obtained by filing a petition for review within thirty (30) days of the service of this order. Section 2-4-702, MCA.